$50.00 ANNUALLY
40 Letters Per Year

DOW THEORY LETTERS

"The Market as Interpreted under the Dow Theory"

RICHARD RUSSELL
P. O. Box 15196
San Diego 15, California

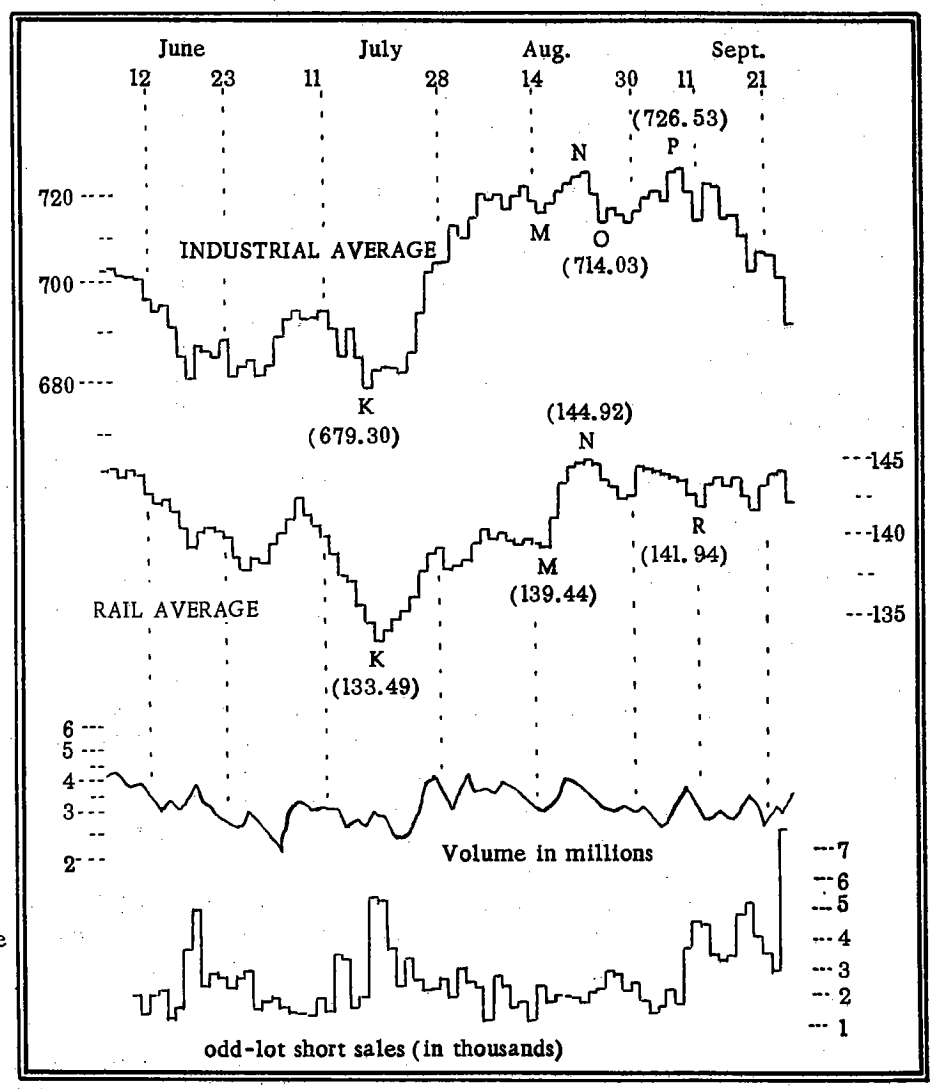
Registered with the Securities and Exchange Commission

THE MARKET In the last Letter I wrote: "If both Averages violate their recent lows (Industrial at point 0-714.03, Rails at point R-141.94) on increasing volume, the secondary trend will have reversed from bullish to bearish, and trading profits will be definitely in order." On September 18 Industrials dropped below point 0; one day later, on September 19, Rails confirmed by sinking 35¢ under their preceding low at R. Volume receded slightly on the Rail penetration, and a sluggish two-day rally attempt ensued. On Friday (September 22) Industrials broke to another low, and this was followed by broad weakness on Monday (September 25).

Note on the chart that subsequent to the initial Industrial penetration of point M, that Average formed a series of bearish descending zig-zags. From the standpoint of the price structure, however, the single hopeful indication is the fact that Rails (although they also formed a series of descending zig-zags) have not yet penetrated their comparable M point (139.44). A persistent refusal by Rails to penetrate M would call for at least a minor upward reversal. Conversely, a Rail penetration of M on increasing volume would be looked upon as a crumbling of the last sign of strength in the current price structure.

CONCLUSION: Two points should now be watched closely--the M (139.44) level on Rails and the K (679.30) level on Industrials. Whatever strength has existed over the last few weeks has been in the Rails, and this will have an important bearing on the market. If Rails hold persistently above M, an (upward) reversal can be expected. Conversely, a Rail penetration of M with Industrials dropping below their July low (K-679.30) would be extremely ominous. A further drop taking Rails under their July low (K-133.49) on heavy volume would suggest a primary reversal.

The secondary trend is now bearish. The primary trend is taken to remain bullish.



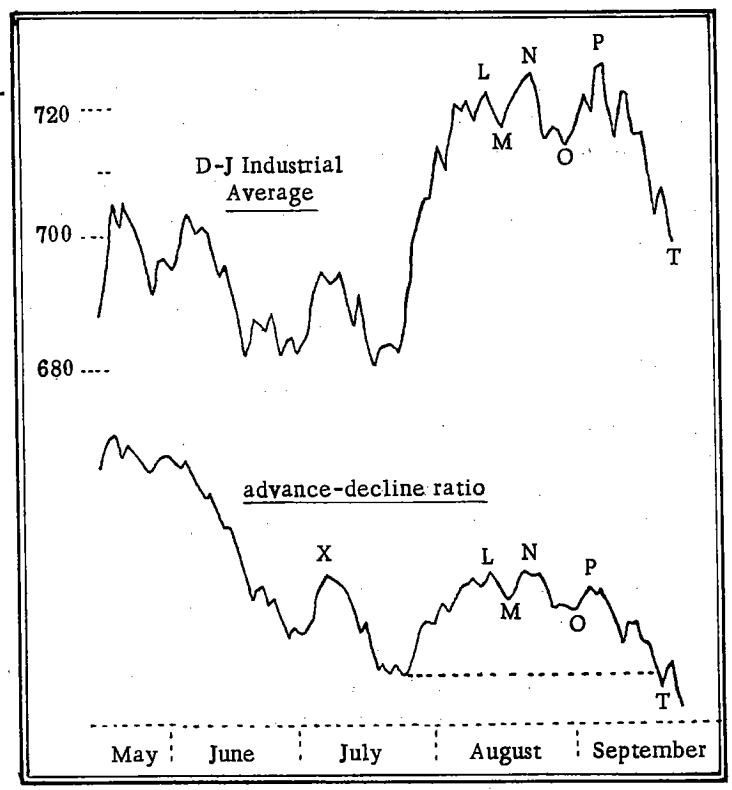
OPPOSING FORCES Seldom have the technical "underpinning" of the market been so mixed. I have included a chart of the advance-decline ratio, and here we see a clear-cut example of deteriorating "breadth". At point L (August 4) the Industrial Average rose to an all-time high while the A-D ratio (which is representative of all the stocks on "the Board") barely touched its earlier July 6 peak (at X). The decline to M ensued. At N (August 22) the Industrial Average rallied to a new all-time high, and here the A-D ratio refused to better its preceding peak at L. The decline to O ensued. On the final rally to a third all-time high (September 7 at P), the Industrial Average again

received no confirmation from the general market, and the A-D ratio at P refused even to rise above the preceding peak at N. The sharp drop to T followed, during which the A-D ratio actually sank below its July bottom (this brought the ratio back to the levels of early January). At the July low the Industrial Average stood at 679.30. If the Industrials persistently refuse to confirm the A-D ratio on the downside, we will have an interesting non-confirmation, and the way will be open for a reversal. Obviously, an Industrial penetration of the July low would be extremely bearish.

Against this background, it is interesting to note that the public, as represented by the odd-lot (under 100-share) buyer, has turned quite bearish, and this is one of the hopeful signs in the current technical picture. Odd-lot transactions since early July have been swinging back to the selling side, and equally significant, that most speculative of all market elements--the odd-lot short seller--has recently been "playing" for the decline.

Studies over many years suggest that there is no "wronger" group in the market than the odd-lot short seller. As a rule, the odd-lot short will not put out his wares until the market has already sustained a sharp drop. When that occurs, the odd-lot short convinces himself that the decline must continue, and he steps up his shorting operations.

The chart on page 1 shows daily odd-lot short transactions since early June. Note the heavy odd-lot short totals during mid-June and mid-July. This shorting occurred at the bottom of each decline, and the market rallied almost immediately thereafter. Recently (see chart), odd-lot shorting has picked up again, and if odd-lot short totals of 3.5 to 5 thousands shares per day continue, it is doubtful whether the market will go much lower at this time.



If another rally starts from this area, it will be important to watch the A-D ratio. A refusal by the general market (the ratio) to follow the Industrial Average would almost certainly call for at least a consolidation, with a secondary reaction very much a possibility over the intermediate term.

THE PRIMARY TREND The most important single piece of information that any investor can possess is a knowledge of the direction of the primary trend. When the great tidal force or primary trend of the market is up, the (regardless of temporary reactions) sooner or later almost all stockholders will make money. When the primary trend is down, then regardless of "hopes, wishes" and passing rallies, almost everybody will lose money.

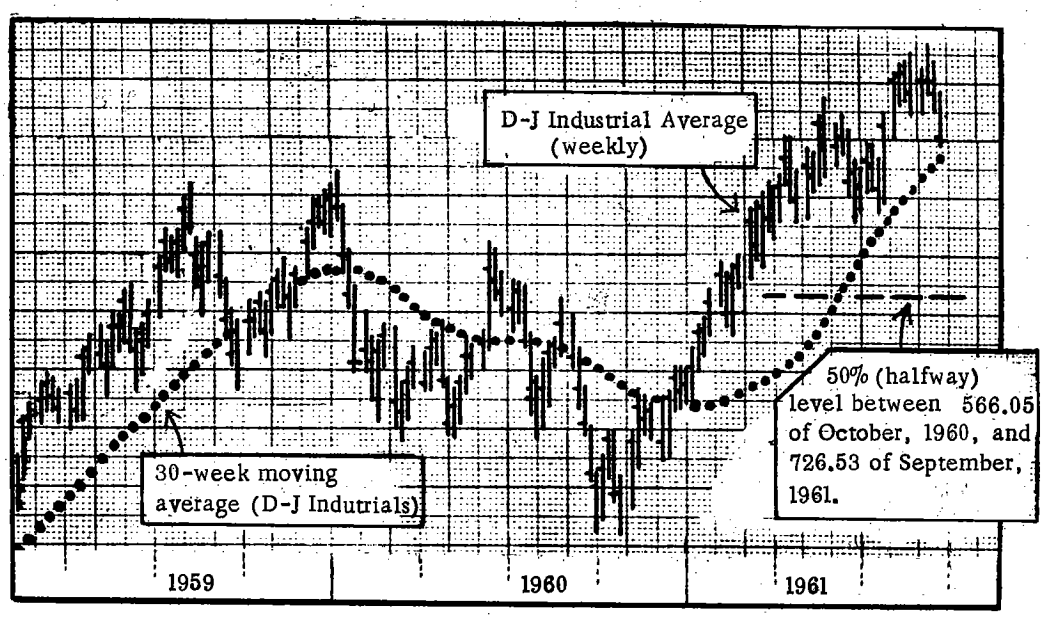
Letter 153 contained a study entitled "Checking the Primary Trend" (extra copies on request--send stamped self-addressed envelope). In that study I noted that at major primary turns the market displays a "falling away" action (with few stocks offering any real resistance to the general decline). Letter 153 went on to say that during primary reversals, three separate phenomena usually present themselves (thereby providing evidence of the turn from bull to bear market): (1) A Dow Theory bear signal is given by the Averages. This consists of a full secondary decline, an upward retracement wherein one or both Averages fail to better the previous highs, and another decline which takes both Averages below the preceding secondary reaction lows on accompanying heavy volume. (2) In the course of the initial primary decline, the D-J Industrial Average violates its own long-term or 30-week moving average. When this occurs, we have evidence pointing to the seriousness of the situation. (3) During severe bear markets the 50% or halfway level of the previous primary advance is almost always violated. This too, provides evidence that the "back of the bull market" has been broken". In only two instances since 1896 (1899-1900 and 1946-47) did bear markets fail to shatter the 50% level of the previous primary advance.

Because of the current market weakness, I believe it is worth reviewing these three criteria again. The accompanying chart shows the path (weekly) of the Industrial Average and its own 30-week moving average. On Monday (September 25) the Industrial Average broke below its moving average for the first time since late 1960. This alone implies a decline of some importance.

Following the violation of the long-term moving average, if the decline continues and the 646 or 50% level (646 is halfway between the 1960 low and the 1961 high - see chart) is broken, the implication will be most serious, and the odds

will point to the existence of a major bear market.

If the decline stops short of the 646 level, and a new advance takes both Averages towards, but not above, the recent highs (Industrials 726.53, Rails 144.92), and if a new decline the succeeds in taking both Averages below whatever secondary reaction lows are established, we will have a Dow Theory bear signal. In that case, the odds will heavily favor the 50% level (646) being broken on the next downward leg. A breaking of the 646 level would reconfirm the existence of a major bear market.

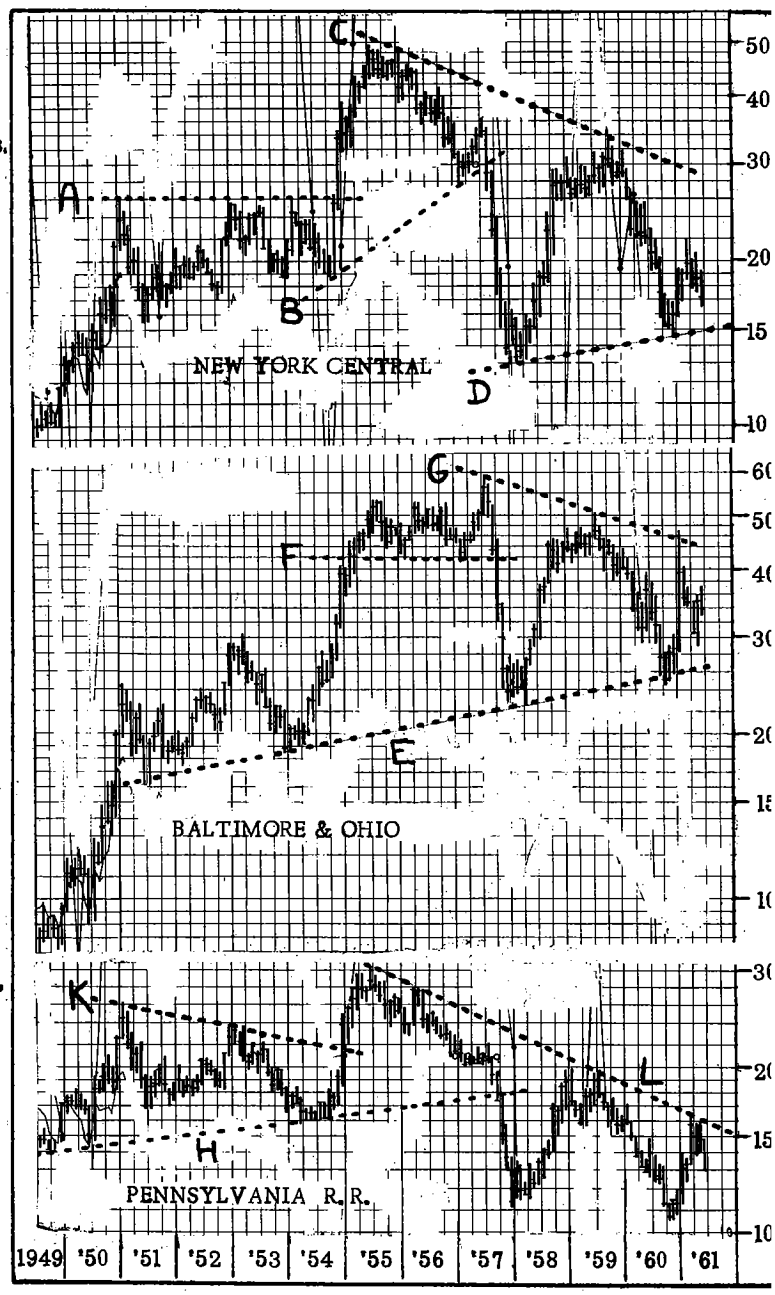

D-J Industrial Average (weekly)
50% (halfway) level between 566.05 of October, 1960, and 726.53 of September, 1961.
30-week moving average (D-J Indutrials)
1959
1960
1961

Conversely, of course, the absence of (1) a bear signal, (2) a penetration of the 50% (646) level, will imply that the primary bull trend is still in force, and that in due time new highs should be seen in the Averages.

MORE ON TRENDLINES Following last week's discussion of trendlines and the Averages, many letters arrived requesting information on trendlines and individual stocks.

Everything that was said in Letter 156 regarding trendlines can also be applied to individual stock charting. In the case of individual stock charts, however, I find it desirable (1) to use monthly charts showing the monthly high-low range on each issue, and (2) to apply trendline methods to cyclical issues as opposed to the so-called "growth stocks". The reason for this is that cyclical issues, historically, tend to move faster and further than other stocks during a given period of economic expansion (cyclical issues usually start their move from overly depressed levels -- then go too high). Moreover, trading in cyclical issues can be more closely coordinated with conclusions regarding the primary trend of the market (growth stocks are apt to move more independently of the major market trend). When the primary trend of the market is bullish and a cyclical stocks breaks above a major trendline, we have a double confirmation forecasting an important rise in that stock. Obviously, the converse is true during a bear market.

For purposes of illustration, I have included charts of three of the (now depressed) Eastern Rails: these are N.Y. Central, Baltimore & Ohio and Pennsylvania. Although the Rail group and these three stocks in particular are considered to be "bad actors", a great deal of money has been made in the past in the Rail group and in these three stocks (and I have no doubt that money will be made in the group and in these three stocks again). In other words, it's the old story: "Don't tell me what to buy -- tell me when to buy it!" Trendlines, properly used, can be a great aid in determining "when to buy".



 From 1951 through 1954 N.Y. Central (CN) fluctuated under its trendline marked A on chart, while building an important series of ascending bases. In 1955 CN finally broke above the A trendline, and the stock promptly rose from 26 to 49. Obviously, commitments in CN following the break above A were extremely profitable. During 1954 to 1956 the B trendline was formed. When B was violated, CN dropped violently to the 12 area. The movements on CN are now contained within two trendlines -- C and D. If CN can rise above C (about 28) the implication would be most bullish, and the stock will be a "buy" for a rise to or above the old high. Conversely, a drop below D (about 15) would have bearish implications.

Baltimore & Ohio (BO) is considered a "dog" by most investors, yet a study of a 10 year chart of BO shows that the stock has held consistently above its major ascending trendline (E). During the 1954-57 rise, BO formed the trendline marked F. When F was broken in 1957, BO plunged from the 50's to the 20's. As with CN, BO is now fluctuating between its major trendline (E) and a bearish descending trendline (G) connecting the 1957, 1959 and 1961 peaks. A rise above G (about 43) would be an exceedingly bullish development, while a drop below E (about 26) would be extremely bearish for BO.

Pennsylvania (PA) held above its major trendline (H) from 1949 to 1957. When the trendline connecting the 1951 and 1953 tops (K) was bettered, PA embarked upon a violent advance (during 1954-55). In 1957 PA's major trendline H was finally shattered and the stock dropped to 11. Note that the H trendline offered resistence to upside progress during 1958 and 1959. PA has been moving under the bearish trendline (L) since 1955, but a rise above L (about 16) could mean a major reversal for PA.

During upward penetrations of trendlines, it is desirable to have accompanying heavy volume. The converse is not true during downward penetrations. The reason is well known: it takes volume to advance a stock (particularly above a resistence level), but a stock can fall of its own weight (in the absence of buying interest).

STOCKS Eight of the seventeen "key" stocks in our "continuing study" are now holding above their long-term or 30-week moving average (M. A.). This is a drop of two from last week (which means that less than half of the seventeen stocks are still in a bullish position).

DuPont has been getting nowhere since its July high of 237 3/4. Its M. A. stands at 217 with critical support at 206. I list the stock as bullish.

General Motors remains bullish and is holding well above its M. A. of 46 1/4. Important support for G.M. comes at 44, and it should be noted that the Auto group is now one of the stronger groups on "The Board".

International Paper came back to "test" its M. A. (33 1/4) on September 25. IP has been fluctuating wildly all year and would have to break 29 to look definitely bearish.

Standard of Jersey (see chart) hurdled its M. A. in December, 1960. The tops came in April and since then the stock has been drifting (a "head-and-shoulders" distribution seems to have formed, starting in February of this year). If Jersey drops to the 42 (or below) area I would list it as definitely bearish (M. A. is now 45 5/8).

Southern Pacific continues to outperform the Rail group and the market. For the last six weeks it has held in a "line" between its all-time high of 27 3/4 and 25 7/8. The stock remains bullish (M. A. now 24 3/8) and would probably be a buy it goes to a new high (on volume) again.

This week Alcoa (see Letter 156) broke below its critical 69 level; for this reason, I feel the stock has "topped out" and should be sold.

Stocks which look like good short sales on rallies are Motorola and Corning Glass.

(Written Tuesday, September 26, 10 A.M.)